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C O N F I D E N T I A L SECTION 01 OF 02 BUDAPEST 000357

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STATE PASS JLAMORE, COMMERCE PASS SSAVICH, ITA/TRADE
COMPLIANCE CENTER

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SUBJECT: HUNGARY: ETHICAL CODEX ENCOURAGES FOOD STORES TO
STOCK HUNGARIAN PRODUCTS

Classified By: Acting P/E counselor Jon Martinson, reasons 1.4 (b,d)

11. (U) Summary: On April 9 2009, representatives of major supermarket chains, food producers and processors signed a voluntary ethical codex that "requires" 80 percent of shelf items to be Hungarian products. Although portrayed as a symbol of good faith, international retailers such as Tesco (UK) and Auchan (France) say they signed the codex under threats of forcing legislation. As the Hungarian food market is providing all it can produce, experts do not foresee major trade implications at this point. End summary.

BACKGROUND-- NOT PLAYING NICE

12. (U) While farmers and processors complain about high shelf fees and expensive in-store advertising costs, the stores counter that farmers are quick to break contracts in search of higher profits abroad. When milk demand in Italy skyrocketed, Hungarian dairy farmers broke their contracts with local stores to export milk to Italian markets. Hungarian stores had to import milk from Slovakia. These and other actions led to demonstrations and protests. Last summer, farmers threw watermelons at grocery storefronts, and poured milk down the store aisle to show dissatisfaction with business agreements.

13. (U) In response, the Minister of Agriculture (MOA), Jozsef Graf, called the parties to negotiate an agreement last autumn. The resulting ethical codex is couched as a Q gentleman's agreementQ, and does not have the force of law. However, Minister Graf used the threat of possible future legislation to force some parties to the table. A number of expertsQ, claim that the Q 80 percent HungarianQ, requirement is politically motivated and protectionist in nature. However, for farmers, Minister Graf is a hero.

REALISTIC IMPACT OF 80 PERCENT HUNGARIAN PRODUCT REQUIREMENT

14. (SBU) There is a large foreign company presence in the Hungarian food market. Additionally, many ingredients are imported to process food domestically. With international involvement in every step of the Hungarian food chain, from growing to processing, it is extremely difficult to define what is a "Hungarian" product. Accordingly, the codex does not.

15. (SBU) In conversation with Pol/Econoff on April 29, Laszlo Varkonyi, Director General of the Trade Policy Department in the Ministry of Economy (MOE), stated that, "This is a form of Q soft persuasionQ, and will not change business

arrangements. It is unrealistic to think that the Hungarian market could provide each category of food." Many experts believe that the Hungarian product requirement is more of a public relations exercise in support of the produce, dairy, poultry and pork sectors. The codex states that, if the quality, quantity and the price is right, consider stocking Hungarian products. Varkonyi estimates that stores already stock 75 percent of these Hungarian products.

¶6. (U) The current Prime Minister and former Minister of Economy, Gordon Bajnai, has said it is impossible to stock the shelves with 80 percent Hungarian products. The Hungarian food supply chain simply cannot meet the demand.

INTERNATIONAL CONCERNS AND TRADE AGREEMENTS

¶7. (U) According to Minister Graf, this voluntary agreement between the stakeholders is better than a new law, as legislation would have required negotiations with Brussels. Also, the current form of the codex complies with the existing EU trade rules as it is voluntary in nature.

¶8. (C) Representatives from Tesco and Auchan believe that the codex is inconsistent with EU rules and Hungary's commitments under the WTO, as well as G-20 commitments not to undertake protectionist trade measures. The UK Foreign Commercial Attaché stated, "This is a cunning weave by the Minister Graf to promise farmers something he cannot deliver." She explained that retailers were concerned about

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signing. France, Germany, the Netherlands, and the UK agreed it is not a good idea and impedes business opportunities, but are even more concerned about potential for future fines should Hungary give these 'voluntary commitments' the force of law. Tesco signed via the Retail Association.

¶9. (SBU) The codex will enter into force on July 1, 2009. The MOA established a board to observe and evaluate the results of the codex through the end of this year. After this, if necessary, MOA is committed to put forward a law, based on parliamentary consensus, to regulate the market. Meanwhile, sources suggest that the European Commission and the Hungarian Competition Advocate Office are both reviewing the legality of the codex.

¶10. (C) Comment: Competing with old Europe in food chain efficiency is daunting for Hungary, but protectionist measures will not incentivize innovation or efficiency. Most experts agree that the 80 percent Hungarian product requirement is neither sustainable, nor enforceable. Nonetheless, we will continue to monitor the developments of the codex for potential market access barriers for U.S. products or for violations of Hungary's international trade commitments. End comment.
Levine